Supreme Court, U.S.
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No. 80-212

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

D. DOYLE MIZE and FARNHAM CORPORATION,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITIONER'S REPLY TO SECURITIES AND EXCHANGE COMMISSION'S BRIEF IN OPPOSITION

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OPINIONS BELOW, JURISDICTIONAL STATEMENT, STATUTES AND RULES INVOLVED, AND STATEMENT OF THE CASE ARE SET OUT IN FULL IN PETITIONERS' PETITION TO THIS COURT.

ARGUMENT

Within the constraints imposed by Supreme Court Rule 22.5, this Reply Brief will address, in abbreviated form, the contentions raised in the Brief for the Securities and Exchange Commission in Opposition (hereinafter "Br.").

1. The Fifth Circuit decision of which review is sought explicitly limited the scope of the remand of this case to the trial court:

> *Although we have found that the defendants did engage in past violations of the federal securities laws* [emphasis added], we have not considered the question of whether these defendants are likely to engage in *future* [emphasis in original] violations. For this reason, we remand the case to the district court for further consideration. On remand, the district court should reconsider its finding of no reasonable likelihood of future violations *in the light of our determination that past violations did occur.* [emphasis added] Petitioners' Appendix (hereinafter "Pet. App.") B-18.

The Fifth Circuit has thus painstakingly instructed the trial court that the remand is to be limited to the issue of the likelihood of future violations and that in hearing the evidence on that issue, the trial court is to accept as a fact that the question of past violations has already been conclusively adjudicated. The quoted language demonstrates clearly that the Court of Appeals found — from the SEC's evidence alone — that a violation of the securities laws had been proven conclusively. The Solicitor General (in a thinly veiled confession of error) argues that Petitioners will be permitted to introduce evidence on the issue of past violation of the securities laws in the event of a remand. Br. 8-10. However, the trial court may feel compelled to heed the clearly expressed instructions of the Court of Appeals and receive evidence only on the issue of the "reasonable likelihood of future violations" of the securities laws. It is this result, so clearly intended by the panel of the Fifth Circuit, which Petitioners submit to be violative of their constitutional rights to due process, and a confession of error by the Solicitor General is no guarantee that such a result will not obtain. Only a decision of

this Court reversing or vacating the judgment of the Court of Appeals will insure that Petitioners will be permitted, if the case is remanded rather than reversed and rendered, to present their evidence to the trial court on all issues. It is the Fifth Circuit's opinion, not the SEC's apparent confession of error,[1] which Petitioners seek to have reviewed by this Court.

Petitioners' concern that the SEC's confession of error does not assure them that upon remand to the trial court the Petitioners will be given the right to re-open the issue of past violations is not mere premature speculation. On September 29, 1980, Mr. Robert A. Hall, one of Petitioners' attorneys of record, contacted Mr. Douglas J. Scheidt, one of Respondent's attorneys of record. Mr. Hall asked Mr. Scheidt if the SEC would agree to submit to this Honorable Court, at this time, a joint motion and an agreed order remanding this case to the Court of Appeals for reconsideration of the Court of Appeals' instructions to the trial court concerning what issues could be considered on remand. Petitioners are of the view that such a procedure would enhance the likelihood of their being allowed to offer their evidence relative to past violations. Mr. Scheidt advised Mr. Hall that the SEC would *not* agree to join in such a motion and order. Thus, not only are the private litigants in the pending related case not bound by the SEC's confession of error, but even the SEC itself apparently does not intend to be so bound upon any remand of this case.

2. Petitioners had no reason to complain earlier in the proceedings in this case, as they have complained to this Court

[1] The SEC also gainsays Petitioners' concerns about the possible collateral estoppel ramifications of the panel's adjudication of past securities violations. Br. 10, n. 9. Petitioners submit that the plaintiff in the pending private lawsuit against petitioners will not be bound by the Solicitor General's confession of error on this Petition. Presumably, the plaintiffs in the private action, buttressed by *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322 (1979), will attempt to assert the collateral estoppel effect of the Court of Appeals' decision in this case, if left unreviewed by this Court. The district court judge to whom the private lawsuit has been assigned is not the same district court judge who will hear this case upon remand.

in their Petition for Certiorari, of the lack of a finding or suggestion by any court below of scienter on their part. Prior to the unusual disposition of this case by the Court of Appeals, the scienter issue had not become relevant in the manner in which it now is.[2] When this case was appealed by the SEC to the Court of Appeals, both parties were of the view that the substantive issue being litigated on the appeal was the materiality of the allegedly undisclosed information. The parties thought that the district court judgment would stand or fall on that basis, with the Fifth Circuit either affirming the trial court judgment or remanding the entire case for a new trial.[3] However, the Fifth Circuit panel not only made a determination on the question of materiality, but also, acting *sua sponte*, made a quantum leap from that determination to the determination that past securities violations had been established. In finding securities violations, the Court

[2] As made clear by this Court's decision in *Aaron* v. *SEC*, — U.S. —, 100 U.S. 1945 (1980), scienter is an essential element of proof for the SEC to establish a violation of the antifraud securities statutes upon which this action is based. Yet, it is clear from the district court's Findings of Fact and Conclusions of Law — especially Findings 10, 15, 16 and 18 — that in passing judgment on the SEC's proof, the district court found a lack of scienter. Implicit in the trial court's conclusion that Petitioners' actions had not violated the securities laws is the recognition of a lack of any fraudulent, deceptive or manipulative intent in Petitioners' conduct. Had the SEC proven a prima facie case at trial, defendants-Petitioners were prepared to produce the testimony of some seventeen witnesses, much of whose testimony would have been to the effect of a lack of scienter.

Though finding violations of the securities laws, the opinion of the appellate panel below nowhere finds or suggests scienter on the part of Petitioners. Rather, in the panel's analysis, nondisclosure of information found to be material, with no inquiry whatsoever into Defendant's state of mind or intent, constitutes an automatic violation of the securities antifraud statutes. This analysis was flatly repudiated by this Court in its decision in *Aaron, supra*.

[3] In their briefs in the Court of Appeals, the relief sought by the SEC was a remand of the entire case to the district court. SEC Brief at 40; SEC Reply Br. 15. Petitioners (appellees below), of course, sought affirmance of the district court's judgment of dismissal. Appellees' Brief at 35. It could not have been reasonably anticipated that the Fifth Circuit would render in part and remand in part — a result which both parties apparently find erroneous. *See* Br. 8-10.

of Appeals' opinion puts into issue, for any review granted by this Court, all elements required to support that finding, including, of course, the element of Petitioners' intent. *Aaron* v. *SEC*, — U.S. —, 100 S.Ct. 1945 (1980).

Therefore, Respondent's argument that Petitioners have not adequately preserved the issue of scienter for review by this Court, Br. 10, is without merit. Petitioners should not be penalized for not raising before the Court of Appeals' decision that which was not an issue until that decision. Only since the Fifth Circuit made the unanticipated disposition of this case it did on April 23, 1980, has the issue of scienter been relevant in its present form. Petitioners submit that their position is further strengthened by this Court's intervening decision in *Aaron, supra*, handed down on June 2, 1980.

3. The major portion of the SEC's Reply Brief is an attempt to justify the SEC's theory of materiality in this case, substantially adopted by the panel's opinion. Br. 10-13. Petitioners are prepared to show to this Court, if the Petition is granted, that the SEC's theory is not in accord with the great weight of authority, but is, instead, a novel odyssey in speculation.

Under the SEC's[4] theory, the Peterson proposal evidently became material[4] for disclosure purposes on the afternoon of May 13, 1975.[5]

[4] The SEC's theory as to the timing of materiality in this case suffers from fatal inconsistencies, as does the Fifth Circuit's determination of it. As noted in footnote 5 hereinbelow, the major thrust of the SEC's theory, as substantially adopted by the Court of Appeals, is to the effect that the Peterson proposal became material on May 13, 1975, the date on which Petitioner Mize was notified of the Crocker National Bank's tentative, preliminary action on the request for financing. However, there are also suggestions in the panel's opinion, at Pet. App. B-17, and in the SEC Brief, Br. 11, n. 10, that disclosure of the Peterson proposal should have been made even earlier, so that investors could decide whether to buy, sell or hold Southdown securities *prior to* May 13, 1975, which was also the record date of the Valhi spin-off. Thus, in its zeal to prosecute this case, the SEC is advancing the untenable contention that the idea being considered should have been disclosed before it became material. Indeed, it is unclear from the Court of Appeals' decision whether an idea such as

The evidence established — and was nowhere called into doubt either in the SEC's evidence or in the Court of Appeals' opinion — that the proposal was permanently abandoned *two days later*, on May 15, 1975. Though Petitioners vigorously dispute that the Peterson proposal ever became material[6] (therefore requiring public disclosure), even if the theory of the SEC and

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that embodied in the Valhi/NA/CP memorandum becomes material when it is first conceived, when it is first reduced to writing, when it is first discussed with interested parties, or when steps toward implementation are undertaken in preliminary fashion.

Petitioners submit that the materiality issue presented in this case is worthy of this Court's attention because, if the Fifth Circuit's obfuscated analysis of it is allowed to stand unreviewed, confusion will result. Consider the dilemma corporate managers and counsel face in making the decision concerning when an idea, such as the one contemplated in this case, should be disclosed to the investing public. If it is disclosed prematurely, the SEC will accuse them of attempting to promote the stock of their company. Yet from the facts of this case, the failure to disclose an idea which never passed the most embryonic stages of development has been held by the Court of Appeals to be a violation of the securities laws.

[5] It was on that date, in the view of the SEC and of the panel below, that the second of what the panel perceived as "the two principal hurdles," Pet. App. B-15, to implementation of the Valhi/NA/CP memorandum was "successfully surmounted," *id.*, by the California bank's tentative approval of Petitioners' request for financing. In the Court of Appeals' view, these two hurdles were "convincing Peterson of the merits of the deal and obtaining the necessary bank financing." *Id.* It is significant to note that to accept the conclusion that these two hurdles were ever overcome, one must completely ignore the undisputed evidence that (1) although Peterson indicated to Petitioner Mize his preliminary agreement with the proposal, he also made it abundantly clear that he would pursue *other* buyers for his National Alfalfa stock and that he and Mize had no "deal," and (2) bank financing was never "obtained" because the Bank never went beyond a mere preliminary approval of the financing application, subject to the provision that all other points in the Valhi/NA/CP memorandum be finalized. In sum, not only were the *two* hurdles perceived by the Court of Appeals never surmounted by Petitioners, but many *other* hurdles (as set out in the Valhi/NA/CP plan) were also never overcome — hence the failure and abandonment of the proposal.

[6] In this regard, Petitioners object to the Fifth Circuit's and the SEC's enshrinement of one line of testimony by Petitioner Mize at trial, quoted in the opinion at Pet. App. B-17 and by the SEC at Br. 6, as

the Court of Appeals is accepted as correct, the proposal was imbued with materiality in a legal sense for less than *two days*. Petitioners maintain that, even if the Peterson proposal did become legally material on May 13, 1975, it would have been physically impossible to have completed the actual mechanics of public disclosure (involving close work with attorneys,[7] printers and others) by May 15, 1975, the date on which the proposal was abandoned, never to be resurrected. Moreover, by the time of the Farnham counter tender-offer in late July, 1975, the Peterson proposal had been abandoned for over two months. And yet, because in the SEC's view that proposal had ripened

absolute, clear proof that the Valhi/NA/CP proposal would have been implemented but for the private litigation commenced on May 15, 1975. Petitioners would direct the Court's attention to the portions of Mize's testimony apparently ignored by the Fifth Circuit and by the SEC, which establish that the Valhi/NA/CP proposal never became anything more than an embryonic gleam in the eye:

Q: Now, Mr. Mize, when you and the McCarthys met with Mr. Peterson up there in Nebraska on April the 15th, 1975, did you and Mr. Peterson reach any agreement at that time whereby he agreed to sell his stock and you all agreed to buy it?

A: No.

* * *

Q: Would you please tell us, sir, after Crocker [National Bank] said that it would in all likelihood make the loan on May 13th, 1975, what else was yet to be done to accomplish the proposal that was set forth in that Valhi/NA/CP memorandum?

A: Well, as far as the Valhi was concerned, the lawyers had to function.

Q: What do you mean by that?

A: I mean they had to determine whether or not what we were purchasing was something that was legally acceptable and possible. After that was determined, the auditors, accountants, had to get into the picture. The thing had to be presented to the board. The board had to accept it. Then the documents, formal documents, had to be prepared. The contract would have to be negotiated with Mr. Peterson and his lawyer and the loan agreement would have to be prepared, which is no small matter.

[7] Although the attorneys for the company had been given a copy of the Valhi/NA/CP memorandum in April, 1975, they had been instructed to do no work on the transaction it described because there was so much uncertainty that a deal would ever be made.

into materiality within the meaning of the securities laws for a period of two days, the SEC contended, and the Court of Appeals agreed (Pet. App. at B-17), that the counter tender offer materials should have included disclosure of the prior matter, because under a hypertechnical reading of the cases construing the securities laws, it had been material for a period of two days, prior to its abandonment. Such a bizarre view of the materiality concept embodied in the securities laws is deserving of this Court's attention.

Furthermore, there is a serious misreading of the Court of Appeals' opinion in the SEC Reply Brief. At Br. 10-11, the SEC argues that the Fifth Circuit's determination of the materiality issue was correct because in this case reasonable minds could not differ as to the materiality of the allegedly undisclosed information. However, the panel's analysis of materiality cannot be defended on that basis.[8] The panel did *not* view the materiality issue in this case as being one on which reasonable minds could not differ. Indeed, its resolution of the issue illustrates the very negation of that view. It weighed the SEC's evidence on the issue of materiality, recognized that the evidence could support a finding either way on the issue and concluded "[W]e believe the balance in this case tips in favor of materiality." Pet. App. B.15.

Petitioners submit that the instant case presents an appropriate vehicle for the Court to remind the federal appellate courts of their proper, limited function in reviewing judgments in non-jury cases. When the Fifth Circuit panel below undertook to balance and tip the factual evidence presented, it usurped a

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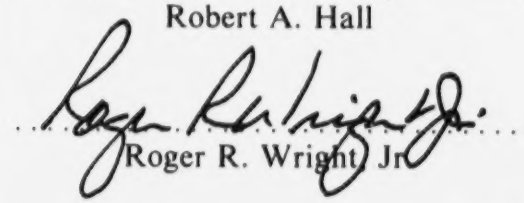
[8] In this connection, Petitioners also feel compelled to point out to the Court a blatant instance in the Reply Brief in which the SEC seriously misstates factual matters to bolster its theory of materiality. At Br. 5-6, the SEC states that the "negotiations concerning the Peterson proposal occurred contemporaneously with the consideration by Southdown directors of the spin-off of Valhi." The record, however, reveals contrary facts. Southdown directors' deliberation on the Valhi spin-off were concluded on March 27, 1975, when the board unanimously voted to approve the spin-off plan. The record shows that the Valhi/NA/CP memorandum was not prepared until April, 1975, and that Mize's first visit with Mr. Peterson to discuss the matter occurred on April 15, 1975.

function reserved by our jurisprudence to the trial court. In so doing, it not only spawned needless judicial diseconomy, it also dealt gross unfairness to Petitioners with its partial rendition of judgment against them and the tortured procedural posture it gave to the case.

Petitioners again pray for the relief sought in the Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, or alternatively, that the opinion below be vacated and the case be remanded to the Fifth Circuit for reconsideration in light of the concessions in Respondent's Brief.

Respectfully submitted,

Robert A. Hall



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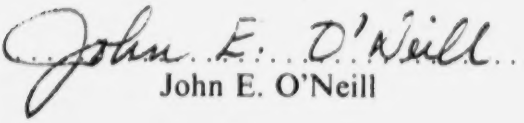

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CERTIFICATE OF SERVICE

I hereby certify that on the 12th day of October, 1980, a true and correct copy of the above and foregoing Reply was served upon the Respondent's attorney of record by placing same in the United States mail, postage prepaid, sent certified mail, return receipt requested and addressed to Michael K. Wolensky, Associate General Counsel, and Douglas J. Scheidt, Attorney, Securities and Exchange Commission, 500 North Capitol Street, Washington, DC 20549, and upon Wade H. McCree, Jr., Solicitor General, Department of Justice, Washington, DC 20530.

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